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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 1058

FRANK C. RAND, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 29–39) is reported in 40 B. T. A. 233. The opinion of the Circuit Court of Appeals (R. 369–378) is reported in 116 F. (2d) 929.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1941 (R. 378). The petition for rehearing filed January 28, 1941 (R. 379–

406), was denied on April 10, 1941 (R. 407). The petition for a writ of certiorari was filed May 15, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the grantor of trusts for the benefit of his children is taxable under Sections 167 and 22 (a) of the Revenue Act of 1934 upon income therefrom applied to payment of premiums on policies of insurance on the life of the grantor taken out by him as trustee for the benefit of the several trusts.

2. Whether there is substantial evidence to support the finding of the Board of Tax Appeals that certain stock became worthless prior to the taxable year, 1934.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 13–19.

STATEMENT

The facts found by the Board of Tax Appeals with respect to the two issues involved are substantially as follows (R. 30–35):

1. The taxpayer is an individual and resides at University City, Missouri. For approximately forty years he has been associated with the International Shoe Company in various positions. In

August 1916, taxpayer was elected president of the company, in which position he served until 1930, when he was made chairman of the board. Since 1920 taxpayer's family has consisted of his wife and their six children (R. 30).

Impressed with the fact that, upon the death intestate of taxpayer's predecessor as president of the company, his son upon attaining his majority would come into a substantial fortune, and being desirous of avoiding a situation of that kind, taxpayer determined to form trusts for his own children, none of whom owned any property and who at that time were all minors. On various dates between 1920 and 1926 taxpayer caused securities to be issued to "Frank C. Rand, natural guardian for," naming the child, the name being followed by the words "a minor donee." Taxpayer's intent in constituting himself natural guardian was to convert the guardianships into trusts for the children when he could determine upon the permanent form for such trusts. Taxpayer, as natural guardian, collected the income of the guardianship estates and kept it separate and apart from any of his or his wife's personal incomes. During this period taxpayer did not use any of the income from the guardianship estates for his own benefit nor did he use any of it to relieve himself from any obligation imposed by law for the maintenance, support, or education of his children. During the minority of the children he provided for their sup-

port, maintenance, and education out of his personal funds. On September 26, 1926, taxpayer's oldest son was to become of age, and on September 15, 1926, taxpayer executed a declaration of trust by which he caused to be transferred to himself, as trustee, the guardianship estate which he had previously held for that child. Similar trusts were created for the other children in October, 1926. All of the trusts, save one, by their terms were irrevocable, and in the one not specifically made irrevocable, there was no provision making it revocable (R. 31–32).

The provisions of the trusts so far as here pertinent are common to all of them. The property was transferred to Frank C. Rand, as trustee, "to hold, manage, and improve said property, with full authority to such trustee to change the investment of the same or any part thereof and to invest or reinvest the proceeds from time to time, with full power to accumulate, invest, change, or reinvest the surplus of any income, dividends and interest from said securities and property, nevertheless for the benefit" of the respective children. At stated times portions of the trust principal were to be turned over to the designated beneficiary and the respective trusts were to terminate on the final distribution of the trust estate (R. 32).

The trust instruments each provided (R. 32–33):

> 1. The trustee shall have the following powers in addition to those hereinbefore

conferred or those ordinarily possessed by trustees:

* * * * *

2. The power to purchase securities at a premium and to charge the premium against principal or against income or partly against income as in the opinion of the trustee may be suitable and appropriate.

3. The power to purchase for cash or on credit securities or other property, and to borrow money from time to time upon such terms as the said trustee may think expedient, upon the security of any of the property of this trust, whether real or personal, and for such purposes to give and execute and acknowledge mortgages, with such powers and provisions as said trustee may think proper, and also to execute and deliver such notes or bonds as it is necessary to use in connection with such transactions.

* * * * *

Taxpayer, as trustee, has kept individual book account records for each of the six beneficiaries of all of the transactions of the trustee, and has kept the trust funds deposited in a bank account known as the "Rand-Six Trusts," and the trustee's books show the separate individual interest of each trust beneficiary (R. 33).

Prior to 1934 none of the income or principal of the trust estates had been used for the purchase of life insurance. In 1934 and for several years previous there had been accumulations of trust in-

come. Taxpayer, as trustee, found it difficult to determine what investments he could advantageously make at that time due to the uncertainty of general market conditions. Substantially the same situation obtained in 1935. In view of this, taxpayer thought a good, safe investment could be made in a substantial amount of life insurance taken out by him as trustee for the benefit of the several trusts. Forty-five separate life insurance policies issued by seven different life insurance companies on the life of taxpayer were taken out in 1934 by taxpayer, as trustee of the respective trusts for his children. The total protection provided by these policies aggregates $1,000,000. The proceeds of all of the policies are payable to Frank C. Rand or his successors in trust, as trustee for his respective children, and, pursuant to the trust instruments, are primarily for the benefit of the respective children. In instances when the right to change beneficiary exists it is exercisable by the trustee (R. 33).

Taxpayer, as trustee, out of the income of the trusts, applied $63,927.53 to the payment of premiums upon the policies of life insurance during 1934, and during 1935 paid $61,606.70 in premiums on the same policies. Since 1935, taxpayer's six children have paid the premiums on the insurance policies out of their own separate property (R. 33–34).

The total income of all of the trust estates for 1934 and 1935 was $322,277.91 and $359,138.20, respectively. The Commissioner included these entire amounts in taxpayer's gross income for 1934 and 1935 (R. 34).

Taxpayer has never used any of the income from the trusts for the direct benefit of himself or his wife, nor has he used it for the support, maintenance, or education of his children (R. 34).

2. The Reorganization Investment Company was organized in 1931 to take over the obligations and liquidate the partnership of Lorenzo E. Anderson & Company, which had been conducting a stock and bond brokerage business in St. Louis, Missouri. Taxpayer and members of his family were creditors of the company to the extent of approximately $665,000. At the time of the organization of the Reorganization Investment Company, taxpayer subscribed $847,166.67, for which he received 847 1/16 certificates of beneficial interest in the stock of the company. (For convenience these certificates of beneficial interest will be hereinafter referred to as stock in the company.) In 1933 taxpayer sold 500 shares of the above stock, which had cost him $500,000, for the net nominal sum of $4. He claimed and was allowed a deduction on this account in his income tax return for that year. On December 27, 1934, taxpayer sold 12 shares of the Reorganization Investment Company stock through St. Louis brokers at the price of ten cents

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per share, which, after deduction of commission, resulted in a net sales price of 22 cents for the 12 shares. This was the stock for which taxpayer paid $1,000 per share in 1931. The balance sheet of the Reorganization Investment Company as of December 31, 1933, shows assets of $1,769,088.83 and liabilities of like amount, including a liability of $48,826.13 in respect of 2,200 shares of capital stock (R. 34–35).

The Board of Tax Appeals specifically found that the stock of the Reorganization Investment Company was worthless prior to 1934 (R. 35).

The Commissioner included in taxpayer's income the total income of the trusts for 1934 and 1935. The Commissioner also denied a deduction from 1934 income in respect of an alleged loss sustained by the taxpayer in connection with stock in the Reorganization Investment Company (R. 18–19, 38).

Upon review the Board of Tax Appeals held that there was properly includible in the taxpayer's gross income only the amount of premiums paid or payable on existing policies (R. 38), but otherwise sustained the Commissioner. The court below affirmed.

ARGUMENT

1. The court below held, correctly, we submit, that the grantor was taxable under Section 167 (a) (3) of the Revenue Act of 1934 (Appendix, *infra*), which provides that where any part of the income

of a trust is applied to the payment of premiums upon policies of insurance on the life of the grantor, then such part of the income of the trust shall be included in computing his taxable net income. The instant case clearly falls within the statute, since the trust income here involved was actually applied to payment of the premiums upon policies of insurance on the life of the taxpayer-grantor. *Burnet* v. *Wells,* 289 U. S. 670; *Rieck* v. *Commissioner,* 118 F. (2d) 110 (C. C. A. 3d); *Heffelfinger* v. *Commissioner,* 87 F. (2d) 991 (C. C. A. 8th), certiorari denied, 302 U. S. 690; *Pillsbury* v. *Burnet,* 67 F. (2d) 151 (App. D. C.) The decision below is not, as contended by petitioner (Br. 21–30), distinguishable from *Burnet* v. *Wells* in any material way.

Cases such as *Higgins* v. *White,* 93 F. (2d) 357 (C. C. A. 1st), and *Commissioner* v. *Waterbury,* 97 F. (2d) 383 (C. C. A. 2d), certiorari denied, 305 U. S. 638, upon which the taxpayer relies (Pet. 13; Br. 31), deal with different situations and statutory provisions; they are not in conflict with the decision below.[1]

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[1] Moreover, it would seem that the grantors in the *Higgins* and *Waterbury* cases could have been taxed under the gross income provisions of the applicable revenue acts corresponding to Section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*). But those cases were decided prior to *Helvering* v. *Clifford,* 309 U. S. 331, wherein the grantor was held taxable under Section 22 (a) because he retained so many of the attributes of ownership of the trust property as to justify treating him as owner altogether for income tax purposes,

In the court below, we urged as an alternative ground in support of the Board's decision that the trust income in question is also taxable to the grantor under Section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*) because he retained sufficient of the attributes of ownership of the trusteed properties to justify treating him as owner altogether for purposes of income taxation. *Helvering* v. *Clifford, supra.* In *Helvering* v. *Fuller,* 310 U. S. 69, this Court indicated that the grantor might be taxable under the rule in the *Clifford* case, *supra,* where he retained substantial control of the trust property even though the trust was for a term of ten years at the expiration of which the corpus was to be transferred to his divorced wife. Here, the grantor, as trustee, retained substantial control over the trust properties, including the right in his discretion to make payments of income or principal to the children-beneficiaries at any time. Any funds not earlier distributed were to be paid over to the beneficiaries at the expiration of stated periods and the respective trusts were to terminate on final distribution (R. 32, 107).

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and the point was not raised in the *Waterbury* case nor in the earlier proceedings in the *Higgins* case. However, after the *Higgins* case had been remanded to the District Court for further proceedings, the question as to applicability of the gross income provisions was raised and decided in favor of the Government upon the second appeal. *White* v. *Higgins*, 116 F. (2d) 312 (C. C. A. 1st).

2. The court below correctly held (R. 377–378) that there was no basis for the claimed deduction in respect of stock of Reorganization Investment Company, since the evidence supported the Board's finding that the stock in question had become worthless prior to the taxable year. *Helvering* v. *Rankin,* 295 U. S. 123, 131; *Helvering* v. *Kehoe,* 309 U. S. 277.

The taxpayer contends (Pet. 14–15; Br. 38–39) that the decision of the court below conflicts with cases stated to have established the proposition that worthlessness cannot be attributed to stock in a corporation which is not insolvent and which is operating as a going concern. *Olds & Whipple* v. *Commissioner,* 75 F. (2d) 272 (C. C. A. 2d); *Coalinga-Mohawk Oil Co.* v. *Commissioner,* 64 F. (2d) 262 (C. C. A. 9th), certiorari denied, 290 U. S. 637; and *Deeds* v. *Commissioner,* 47 F. (2d) 695 (C. C. A. 6th). But those cases turn on their particular facts and are not in conflict with the decision here. As pointed out in the opinion of the Board of Tax Appeals in the instant case (R. 39), the continued operation of the company would not of itself prove value in its stock, particularly where, as here, the company by its very nature was a liquidating company which would presumably continue to operate until its purpose was fulfilled, even though the final result of its operations could leave nothing for the stockholders.

CONCLUSION

The decision below is correct. There is no conflict. The petition should be denied.

Respectfully submitted.

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MAY 1941.